a discount to resellers and that ILECs may not evade the wholesale obligation by consecutively offering a series of 90-day promotions.[47] The FCC has left to state commissions the authority to make specific rules concerning restrictions on discounts and promotions to be applied to resellers in marketing their services to end-users. The state commissions are directed to develop such rules as necessary for use in the arbitration process under 47 U.S.C. § 252. Finally, the FCC has found that restrictions on the resale of volume discount plans should be considered presumptively unreasonable.[48]

Below-Cost and Residential Service. Both CBT and GTE stated that ILECs should not be required to resell services priced below cost. GTE recommended that the Commission adopt general guidelines to ensure that no ILEC is required to resell services below cost.[49] Likewise, CBT stated that the resale price of services currently priced below cost should recover their full costs.[50] The AG pointed out in his testimony that resale of services that are already priced below cost is not prohibited by the 1996 Act and does not affect the contribution received by the ILEC.[51]

The FCC has opined that 47 U.S.C. § 251(c)(4) does subject below-cost services to the wholesale rate obligation. The FCC points out that a service's being priced below

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[47] FCC Order at paragraph 950.

[48] Id. at paragraph 953.

[49] GTE Brief at 12-13.

[50] CBT Brief at 8-9.

[51] Testimony of Dr. Marvin H. Kahn for the AG at 22.

cost does not justify denying the customers of the service the benefits of resale competition. The FCC further concludes that the resale of below-cost services will not affect the ILECs' net income because any change in revenues should be accompanied by a proportionate change in expenditures.[52]

Cross-Class Selling. Most parties agreed that the resale of residential services to nonresidential end-users should not be allowed. MCI believes that the only restriction on resale should be on offering resale to a different class of customers, i.e., residential service should not be resold to business.[53] AT&T also concurred with this position.[54]

The FCC Order supports this position.[55] That Order also allows the state commissions to make similar prohibitions against the resale of Lifeline and other means-tested service offerings to end-users not eligible to subscribe to such services offerings.[56] Based upon the authority conferred on the Commission by the FCC Order, the Commission will prohibit the resale of all means-tested service. Cross-class selling restrictions on all other services, including shared tenant services, are presumed unreasonable. The FCC will allow LECs to rebut this assumption by proving to the state commission that a specific class restriction is reasonable and nondiscriminatory.[57]

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52 FCC Order at paragraph 956.

53 MCI Brief at 27.

54 Testimony of Mike Guedel for AT&T at 10-11.

55 FCC Order at paragraph 962.

56 Id.

57 Id. at paragraph 964.

ILEC Withdrawal of Services. The FCC has declined to issue general rules on the withdrawal of service by an ILEC, but instead has left this power to state commissions. This commission will ensure that procedural mechanisms exist for processing complaints regarding ILEC withdrawals of service.[58] The FCC has, however, stated that it is important to ensure that "grandfathered" customers are not denied the benefits of competition. It also has directed that "grandfathering" must extend to reseller end-users.[59]

Providing Service. MCI states that the Commission must ensure that ILECs offer resellers the same quality service they provide themselves and their own retail customers.[60] To do this, ILECs must have systems and procedures that permit the ordering and use of wholesale facilities under the same timetables available to the ILEC. These systems must include pre-service ordering capabilities, on-line automated order processing, exchanging of billing and customer account data, on-line monitoring, and service quality reports.

The FCC concurs with MCI's position and states that practices to the contrary violate the 1996 Act's prohibition of discriminatory restrictions, limitations, or prohibitions on resale.[61] The FCC further requires that where operator, call completion, or directory

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58 Id. at paragraph 968.

59 Id.

60 MCI Brief at 28.

61 FCC Order at paragraph 970.

assistance is a part of the service or service package, ILECs must comply with reseller branding requests.

The FCC has left to state commissions the responsibility to determine reasonable and nondiscriminatory charges for customer change-overs and the level of fees or wholesale pricing offsets that may be reasonably assessed to recover any costs associated with these activities. The Commission will determine these charges and prices on a case-by-case basis as LECs request approval.

Resale Obligations of LECs

The 1996 Act imposes a duty on all LECs to offer certain services for resale. Specifically, Section 251(b)(1) of the 1996 Act requires LECs "not to prohibit, and not to impose unreasonable or discriminatory conditions or limitations on, the resale of [their] telecommunications services."

The Commission concurs with the FCC decision and its application of this section of the 1996 Act. Section 251(b)(1) of the 1996 Act requires resale of all telecommunications services offered by the carrier, while section 251(c)(4) only applies to telecommunications services that the carrier provides at retail to subscribers who are not telecommunications carriers. Section 251(b)(1) of the 1996 Act omits a wholesale pricing requirement and, therefore, wholesale pricing requirements are not imposed on non-incumbent LECs.[62] Additionally, the FCC found that the rules concerning resale

62 Id. at paragraph 976.

restrictions under Section 251(b)(1) of the 1996 Act should be the same as those under Section 251(c)(4).[63]

Application of Access Charges

We also concur with the FCC's assessment that the 1996 Act requires that ILECs continue to receive access charge revenues when local services are resold under Section 251(c)(4). Interexchange carriers ("IXCs") must still pay access charges to ILECs for originating and terminating intrastate traffic, even when the end-user is served by a telecommunications carrier that resells ILEC retail services. The FCC decided to allow the ILEC to bill the reseller for the interstate subscriber line charge and preferred interexchange carrier ("PIC") charges. From this, we conclude that the ILEC must also recover the Telecommunications Relay Service ("TRS") and Telecommunications Device for the Deaf distribution program ("TDD") surcharge from the reseller for each line served, and that these rates are not subject to wholesale pricing.

## UNIVERSAL SERVICE FUND

This Commission has an established record of supporting universal service goals.[64] Much work has been done in Kentucky to keep residential rates affordable and to increase subscribership. Technological advances are fueling the development of sophisticated services available over communications networks. The Commission will

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63 Id. at paragraph 977.

64 Administrative Case No. 323, An Inquiry into IntraLATA Toll Competition, An Appropriate Compensation Scheme for Completion of IntraLATA Calls by Interexchange Carriers, and WATS Jurisdictionality, May 1, 1991 and December 29, 1994 Orders.

continue to pursue policies promoting subscribership and will continue to work diligently to ensure that the benefits of resale and facilities-based competition are extended to all Kentuckians.

The findings and assumptions discussed in this section are preliminary and interim until the FCC issues its order on universal service expected in May 1997. The Commission, through its staff, will conduct workshops on all issues related to universal service funding as quickly as possible. Furthermore, all persons are invited to file comments on this section within 30 days. These comments will be reviewed in the universal service workshops and will form the basis for workshop discussions.

The Commission believes that during the transition to full market competition, its traditional role will, to some extent, continue. Once significant market competition takes hold, the Commission's regulatory role in those areas will change. However, some parts of the state may never have full local competition. In those cases, the Commission's traditional role will largely continue. The Commission will also encourage high standards for wholesale and retail service and fair business practices, such as the prevention of the unauthorized switching of local carriers, commonly called "slamming." A competitive market is generally self-policing but the Commission will continue to give serious consideration to all customer complaints, including those of end-users or carriers, especially during the crucial transition to full-market competition.

The 1996 Act requires that implicit subsidies supporting universal service be removed from rates.[65] Henceforth, universal service is to be explicitly subsidized. An

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65 47 U.S.C. § 254(b)(5).

intrastate Universal Service Fund ("USF") will be established to comply with the minimum federal standards. The USF will be used to support one single residential access line per Kentucky subscriber and to promote facilities-based competition. The USF will provide direct universal service support and low-income assistance and administrative costs. All telecommunications service providers regulated by this Commission will contribute toward universal service, except for customer-owned, coin-operated telephones ("COCOT"). The assessment will be based upon a percentage of gross intrastate revenues net of payments to other carriers. The USF administrator will be required to file annual reports subject to Commission review. Although any glaring problems will be investigated immediately, a more general formal investigation will be conducted in four years fully to review all issues surrounding the USF.

The Commission also finds that there should be a flash-cut transition in universal service funding. In other words, after considering workshop recommendations concerning USF implementation issues, the Commission will remove non-traffic sensitive ("NTS") rate elements from access charges and from intrastate toll rates.[66] Since ILECs currently receive NTS revenue on a monthly basis, the USF will begin receiving payments from and making payments to telecommunications carriers on a monthly basis. The transition to a USF should cause as little disruption as possible.

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[66] See generally FCC Order at Section VII. Though the FCC Order allows states to maintain implicit universal service funding through access charges and toll rates, Kentucky will move ahead with its universal service fund.

Low-Income Assistance

No party objected to some form of low-income assistance as being appropriate for universal service funding. Low-income households may fail to subscribe to telephone service because of inability to afford the basic local exchange rates or inability to afford toll charges. Attempts to increase subscribership among this group of customers should recognize that policy decisions that address the problems of the former may not address those of the latter. A household that is able to afford the monthly basic local service charge may still do without a telephone when faced with the possibility of high long-distance bills.

Two well-established federal programs, Link-Up and Lifeline, assist low-income households in obtaining and maintaining telephone service. Kentucky currently participates in the Link-Up program. Link-Up assists verifiable low-income households in obtaining telephone service by covering a portion of the installation fees. The Commission elected years ago to forego participating in the Lifeline program, which covers the federal subscriber line charge of $3.50. States are responsible for one-half of the expenses of the Lifeline program. The Commission finds that Kentucky should begin participating in the Lifeline program and that its portion of the expense should be funded through the USF. This will provide additional aid for households that cannot afford local service.

Low-income verification is needed for Link-Up participation, and similar verification procedures should be required for Lifeline. The ILEC or ALEC will be responsible for implementing both programs for its low-income customers. The Commission realizes that some additional cost, unrelated to penetration rate, will be incurred when low-income households which already have a telephone take advantage of the Lifeline program. The additional cost to the USF is, however, unavoidable for reasons of fairness. Any reduction in toll rates resulting from decisions herein may also benefit those low-income households which have difficulty affording toll charges but choose to leave their telephones unblocked.

For those households that cannot afford excessive long-distance bills, the Commission finds that ILECs should provide, on a one-time basis, free of charge, complete toll blocking and a reversal of the toll block. Any customer who so chooses will have local call capability without incurring unforeseen long-distance bills. The cost of subsequent requests for toll blocking or unblocking will be the responsibility of the customer. However, the toll block will be portable if the customer changes location. The USF will cover the cost of the first block and unblock requests.

Carrier Of Last Resort Obligations

Under the traditional regulatory paradigm, the term "carrier of last resort" ("COLR") refers to the statutory obligation of ILECs to at all times be ready, willing, and able to serve every customer in their designated service territories who may request service. There are quality of service standards, safety standards, and other guidelines which must be met to operate in Kentucky. ILECs argue that certain investments have been incurred with regulatory approval to fulfill their service obligations. As such, the depreciation lives of many investments have been lengthened to help keep depreciation expense and local exchange rates low.[67] This has led to an accumulated depreciation reserve deficiency defined as the difference between actual and net book asset values. It is possible that the prior accounting treatment of ILEC investments would have been different under competitive market conditions. ILECs argue that a competitive market in the future will make it impossible for them to sustain recovery of these unrecovered depreciation expenses through implicit support and that fairness dictates they be allowed recovery of this portion of their revenue requirement.[68] BellSouth proposes that accumulated depreciation reserve deficiency recovery should be a short-term component of a USF to be phased out as expenses are recovered.[69] The IXCs and other intervenors generally argue that the ILECs' accumulated depreciation reserve deficiency is not a legitimate item to be recovered through the USF.[70] MCI questions whether the deficiency even exists.[71] Referring to BellSouth's previous $2.7 billion charges for accounting changes and equipment writedowns, KCTA seems to suggest that to the extent a deficiency exists, it should be written off.[72]

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67 Arguments made by BellSouth are indicative of ILEC positions. See generally Direct Testimony of Martin for BellSouth at 12, Direct Testimony of Perl for BellSouth at 10, and BellSouth Brief at 45-7.

68 See BellSouth Brief at 46 and Direct Testimony of Perl for BellSouth at 14 and Transcript of Evidence ("T.E."), Vol. V, at 92-4.

69 Direct Testimony of Martin for BellSouth at 12.

70 See AT&T Brief at 12-13 and T.E., Vol. II of V, at 78-9.

71 MCI Brief at 45-6.

72 KCTA reply comments dated March 11, 1996, at 1-2. Also see Reply Testimony of Montgomery for ACSI at 7-8.

The ILECs' argument is correct to the extent that depreciation rates approved by the Commission would not be representative of rates found in a truly competitive market. Increasing competition may increase the risk of not fully recovering an accumulated depreciation reserve deficiency. However, a complete inability to recover these expenses is not a foregone conclusion. The record does not support the argument that competition, especially facilities-based competition, will occur with such speed that accumulated depreciation expense recovery will be impossible. Nor does the record show that associated plant will cease to be used to generate revenues.[73] There is every reason to believe that ILECs will act aggressively to retain their customer base. Consequently, the Commission finds that ILEC arguments to guarantee recovery of any depreciation reserve deficiency through a universal service fund should be rejected. There are alternatives to traditional rate of return regulation, such as incentive regulation, which may facilitate successful participation in increasingly competitive markets.

All current ILECs will remain carriers of last resort. If an ILEC wants to abandon or sell territory, it must file a petition with the Commission. There will be a formal investigation concerning the conditions surrounding the request to appoint another COLR, if necessary, and to set new USF payments. ILECs may not use petitions to abandon or sell territory to circumvent regulatory responsibilities.

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73 At the federal level, many parties made similar arguments concerning recovery of embedded costs, i.e. COLR obligations and universal service social policy objectives, through interconnection and unbundled network rate elements. The FCC rejected these arguments. See FCC Order at paragraphs 655-9, 663-9, 687-8, and 708.

Non-Traffic Sensitive Revenue Requirement

Until passage of the 1996 Act, universal service was largely supported through implicit subsidies embedded in various service rates. Section 254 of the 1996 Act mandates that all implicit universal service subsidies shall be removed from rates and explicitly provided to ILECs.[74] In Kentucky, the non-traffic sensitive revenue requirement ("NTSRR") portion of the ILECs' revenue requirement determined through residual pricing rules has been recovered through access and toll rates rather than through increased local exchange rates. Such a system is tantamount to universal service funding. This known and measurable revenue stream is the direct result of past Commission actions.[75] Generally, ILECs argue that local service rates are below cost. GTE argues that, with the advent of local exchange competition, a rate structure which includes implicit subsidies cannot be sustained.[76] BellSouth agrees that rate rebalancing should occur, but since it may not be politically feasible, a USF is needed to remove implicit subsidies from rates.[77] IXCs and other intervenors question ILECs' contentions that basic local service is being provided below cost.[78] They also question

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[74] See 47 U.S.C. § 254(b)(5).

[75] Administrative Case No. 323 and Administrative Case No. 273, An Inquiry Into Inter- and IntraLATA Intrastate Competition in Toll and Related Services Markets in Kentucky.

[76] GTE Brief at 6.

[77] BellSouth Brief at 37, Direct Testimony of Martin for BellSouth at 6-7. Also see CBT Brief at 7-8.

[78] AT&T Brief at 6-11, MCI Brief at 43-8 and T.E., Vol. III of V, at 8-11 and 70-1.

the necessity of a local service subsidy, arguing that the revenue realized from all services purchased by residential customers more than covers the associated costs.[79]

The Commission finds that removing NTS rate from access and toll rates goes a long way toward initially satisfying federal mandates. However, this case is not a formal rate proceeding and has not been conducted as such. The Commission finds that there is no basis for denying ILECs full recovery of their respective NTSRRs at this time. Aside from stimulation of toll minutes and the increased revenues, this action should be substantially revenue neutral. Therefore, ILECs will continue to receive their respective NTSRRs through the USF. All customers should see the immediate benefits of lower access charges through reduced toll rates. Consequently, all ILECs shall file tariffs which reflect the removal of NTS rate elements from access charges. Toll providers operating in Kentucky should not realize windfall gains and, accordingly, shall file new tariffs reflecting the amount of access charge reductions as offset by corresponding USF contributions.

Although ILECs argue that their current rate structure needs rebalancing, removing NTS rate elements from access charges and toll rates is the full extent to which the Commission will rebalance rates at this time. With the exception of BellSouth's, the ILECs' rates are currently established under traditional rate of return

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79 See, for example, Direct Testimony of Gillan for LDDS at 40-5, Reply Testimony of Montgomery for ACSI at 3-4, AT&T Brief at 6-9, AG Brief at 7 and T.E., Vol. II of V at 122 and Vol. IV of V, at 130-4. BellSouth readily acknowledges that the entirety of its revenues covers its costs but that is irrelevant regarding the question of local exchange rates being offered below cost. Rebuttal Testimony of Martin for BellSouth at 3.

regulation, so rebalancing must be done in that arena.[80] Despite the NTSRR being transferred to the USF and no longer existing as an implicit subsidy, an ILEC's USF revenue is a potential issue in an earnings investigation to the extent that ILECs realize any additional revenue from increased toll calling, and it should be used to facilitate further rate rebalancing to offset the need for local rate increases.

The Commission finds that the total size of the USF should be equal to the sum of all ILECs' NTSRR, plus the Lifeline amount previously discussed, plus fund administrative costs. In the past, ILECs' NTSRR grew proportionately with access lines.[81] Such will not be the case with the USF at this time.

Administrative Costs

The Commission also recognizes the USF should include reasonable costs of administering the fund. These costs will be determined in a workshop and are further discussed herein.

Universal Service And Basic Local Exchange Service

Most parties argue that the elements of basic local exchange service to be supported by a USF should include only those elements necessary to receive dial tone.[82] In this way the cost of the USF would be kept as small as possible. The Commission agrees with this philosophy and finds that the definition of basic local

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80 BellSouth can rebalance its rate structure at any time within limits established in its price-cap plan.

81 See Administrative Case No. 323.

82 See, for example, MCI Brief at 48-9, AT&T Brief at 10-11, Direct Testimony of Jamison for Sprint at 16-7.

exchange service for residential customers should consist of dial tone, access to touch tone, access to locally provided emergency service (911 and E911), operator services, interexchange services, directory assistance, and a white-page directory and listing. Adding additional services to the basic local exchange definition would add to the size and cost of the USF. Unless federal law mandates otherwise, the Commission will address the need for adding services to the definition as it may arise.

Some parties recommended that TRS/TDD and other services be included in a USF-supported basic local exchange definition.[83] TRS/TDD are currently funded by an assessment on ILEC customers, and the Commission sees no reason to change this funding mechanism. However, the LECs argue that they will be at a competitive disadvantage because of the actual funding mechanism. LECs pass TRS/TDD costs to their residential and business customers. The Commission finds that fairness dictates that the TRS/TDD assessment be tied to customers' access lines. In other words, when an ALEC takes a residential or business customer away from an ILEC, the TRS/TDD assessment will go to the ALEC along with the customer.

Touch tone is inherent in switch software and the ILEC incurs some expense to give a customer pulse service. While the Commission finds it is appropriate to include touch tone service in the basic local service definition, it recognizes that there are some residential customers who do not subscribe to the service. To the extent that customers are already subscribing to and paying for touch tone service, that payment will be rolled

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[83] See, for example, Metro Human Needs Alliance of Louisville, Kentucky, Brief at 8 and Direct Testimony of Martin for BellSouth at 2-3, and AG Brief at 6.

into basic local exchange service rates. There will be no rate increase for these customers. Existing customers who do not yet subscribe to touch tone service will be "grandfathered" and the service will continue to be optional while they remain at their current addresses. For new customers, touch tone will be mandatory.

Most parties agree that basic local exchange rates should reflect their costs, but disagree over what those costs legitimately are. Some parties propose using costing workshops to arrive at the appropriate methodology and cost of basic local exchange service.[84] However, other parties caution that workshops are not always efficient.[85] Some parties advocate using proxy models to estimate the cost of local exchange service.[86] However, the use of proxy models is not wholly accepted either.[87]

BellSouth proposed using actual cost data as reflected in Automated Reporting Management Information System ("ARMIS") cost data filed with the FCC as the most accurate way of determining the actual cost of universal service.[88] This

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84 See, for example, CBT Brief at 7.

85 See ACSI Brief at 14 and AG Brief at 13, and T.E., Vol. IV of V, at 78-9.

86 See, for example, Direct Testimony of Jamison for Sprint at 15-22, MCI Brief at 42-3 and T.E., Vol. II of V, at 217 and Vol. IV of V at 110-2.

87 See, for example, BellSouth Brief at 92-3. Also, even though the FCC indirectly used the Benchmark cost and Hatfield 2.2 proxy models to set interim rates, it acknowledges that further study is needed. See generally FCC Order, Section VII.C.3 and paragraph 794.

88 BellSouth Brief at 40.

recommendation, however, has been criticized as an attempt by BellSouth to recover its embedded costs.[89]

BellSouth, GTE and CBT filed incremental cost studies which detail the cost of providing the local loop.[90] BellSouth's study employed a long-run incremental cost approach and included forward-looking joint and common costs.[91] GTE employed two different costing methodologies: a benchmark cost model ("BCM") for residential service and a long-run incremental cost model, which included forward looking joint and common costs.[92] GTE admits that the "BCM does not define the actual cost of any telephone company, nor the embedded cost that a company might experience . . . . Rather, [it] provides a benchmark measurement of the relative costs of serving customers residing in given areas [census block groups]."[93] CBT's incremental study appears to include historic joint and common costs.[94] These studies did not utilize a Total Service Long Run Incremental Cost ("TSLRIC") methodology, which is advocated by most parties other than the ILECs.[95] Another issue is whether joint and common costs should be

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89 See, for example, MCI Brief at 44 and CATV Brief at 29.

90 BellSouth filed its study in response to AG information request, Item No. 4, dated September 20, 1995. GTE and CBT responded to Commission's Order dated April 3, 1996.

91 Id.

92 Id.

93 Id. GTE's response filed June 3, 1996.

94 Id.

95 See, for example, AT&T Brief at 23-5, AG Brief at 8, Direct Testimony of Jamison for Sprint at 18, KCTA Brief at 16 and LDDS WorldCom Brief at 5.

included in the cost studies. ILECs argue that it is appropriate to recover these costs in unbundled network element rates.[96] This position is also supported by Sprint, MCI and the AG.[97]

In the context of the FCC Order, the local loop and other unbundled network elements are to be priced using a TSLRIC methodology which focuses on each specific element[98] and includes a reasonable allocation of joint and common costs. Unless federal law mandates otherwise, the Commission finds that it is appropriate to include a reasonable share of joint and common costs in calculating the cost of basic local exchange service.

It is clear from the FCC Order that ILEC embedded or historic cost recovery will not be allowed through unbundled network element rates. The FCC has deferred to its universal service proceedings the questions of if and how embedded costs will be recovered. For example, the extent to which proxy models will be allowed for determining the cost of local exchange service remains unclear. Equally unclear is whether large ILECs may use such models. If acceptable, proxy models may be the best method for small ILECs to determine local service costs, while large ILECs may be required to use TSLRIC models. Also unclear is whether a subscriber line charge or some other method will be used to recover embedded costs, if recovery of these costs

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96 See, for example, T.E., Vol. II of V, at 18, and Direct Testimony of Perl for BellSouth at 18.

97 See Direct Testimony of Jamison for Sprint at 18-9, MCI Brief at 42-3, and T.E., Vol. II of V, at 41-2, stating that such recovery is appropriate.

98 This pricing methodology is referred to by the FCC as Total Element Long-Run Incremental Costs or TELRIC.

is allowed at all. Therefore, the Commission will take no action on universal service cost issues aside from that taken herein until the FCC provides further guidance.

The Commission finds that the current ILEC basic local exchange rate plus touch tone charges should constitute the interim price for basic local service. This combined rate will serve as the basis for local exchange service resale rates. The current penetration rates of Kentucky ILECs suggest that current rates are affordable for most Kentuckians. However, the Commission will monitor the effectiveness of the low-income initiatives and make any necessary adjustments.

<u>Who Pays Into Fund</u>

The majority of all regulated telecommunications carriers should pay into the USF, including all ILECs, ALECs, competitive access providers ("CAPS"), IXCs, toll services resellers and wireless providers. To prevent some double counting, the assessment should be based upon a percentage of gross intrastate revenues derived from services sold to end-users, i.e., net of payments to other carriers. Requiring most carriers to pay into the USF will keep individual carriers' assessments as small as possible. However, the assessment would be unduly burdensome for COCOT providers.

The cellular industry argues that it should not contribute to the USF because it already pays toward achieving universal service goals through implicit rate elements embedded in access charges paid to connect to ILEC networks.[99] However, implicit subsidies are to be taken out of access charges, rendering this argument moot. Another argument put forth by the cellular industry is that its service is not a substitute for

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[99] BSCC Brief at 7-8.

wireline service.[100] To a certain degree this is true. However, cellular providers are in the process of upgrading their networks with digital technology which will allow them to compete more effectively with landline and personal communications services ("PCS") carriers. Also, cellular carriers are expanding the concept of what constitutes a local calling area beyond the expanded calling area service concept.[101] There is no reason to believe that present local calling areas will remain unchanged with the advent of local competition.[102] BellSouth uses this argument, in part, as the basis for its proposal to use its switched access rate structure for interconnection agreements, so that its switches could distinguish and track ALEC calls that do not conform to its predefined calling areas.[103] As seen in the Louisville and Lexington example, the cellular industry is a leader of this new trend. Digital technology, new marketing alliances and strategies, and the bundling of service options in the near future may be expected to allow the cellular industry to compete with landline carriers for greater shares of the local market. Wireless service is an integral and growing part of the telecommunications landscape.[104] At least one party envisions a scenario in which wireless could be less

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100 Id. at 2-7.

101 Both Cellular One and BellSouth Mobility advertise that they offer local calling between Louisville and Lexington, Kentucky. The calling scope of these services goes well beyond the calling scope of BellSouth's tariffed area calling service arrangements.

102 Customer choice of calling areas could be a hallmark of local competition. See T.E., Vol. IV of V, at 100-1.

103 See Direct Testimony of Scheye for BellSouth at 10-13.

104 See, for example, Direct Testimony of Martin for BellSouth at 18.

expensive than, and eventually replace, wireline service.[105] Accordingly, the Commission reaffirms its previous finding that all wireless providers should contribute to the USF based on a percentage of gross revenues net of payments to other carriers.

The ILECs generally argue that USF payments to themselves should not be counted as revenue for the purposes of USF assessments. It does not make sense, they say, to assess subsidy payments to provide subsidy payments. Furthermore, such a course of action would lower the actual amount of money received by the ILECs for universal service. However, considering the manner in which the USF has been structured at this time, this argument is without merit. ILECs are to receive a revenue stream from the USF that is equivalent to current NTS revenue obtained through access and toll rates. The ILECs will receive the same revenue stream from the USF that they have been receiving from NTS sources; only the name and source of funds will have changed. ILECs are required to impute NTS rate elements in their toll rates, thus essentially paying into the current USF funding mechanism. Paying into the USF should be essentially no different, since the money is still earmarked to support universal service. Exempting USF revenue from USF assessment calculations would represent a subsidy for which ILECs have not made an adequate case. The Commission finds that ILECs should count USF payments as revenue to be counted toward calculating USF assessments.

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105 T.E., Vol. II of V, at 205.

Who Collects And How

This section addresses universal service goals through general policy guidelines. There are many detailed issues to be worked out in workshops, some of which will be discussed below.

The Commission's universal service goal is to promote, through wireline and wireless technology, connection to the telecommunications network. Maintaining affordable residential rates and bringing the benefits of competition to all ratepayers is in keeping with universal service goals. Therefore, only designated "eligible telecommunications carriers" will receive USF payments.[106] Initially all ILECs will be designated as eligible telecommunications carriers. Subsequently, facilities-based competitors who serve under certain criteria may petition the Commission to be designated as eligible telecommunications carriers and receive USF payments. The criteria for eligibility should include COLR obligations, a prohibition against "cherry picking," and measures to encourage residential line and rural area competition. COLR obligations mean that once a carrier has been designated as an eligible telecommunications carrier and has begun receiving USF payments, it may not abandon territory without prior Commission approval. "Cherry picking" is prohibited in that an ALEC may not provide service to only a select portion of customers within an area as defined by the Commission, such as one served by a central office.[107] A condition of

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106 For the purpose stated herein, "eligible telecommunications carriers" means the same as it does in 47 U.S.C. §102.

107 Several parties argue that a "no cherry picking" provision is unnecessary in competitive markets. See, for example, T.E., Vol. II of V, at 203 and 207-9 and AT&T Brief at 22.

certification for ALECs is that service to all customers within a defined geographic area must be made available through resale, facilities-based competition, or a combination of both.

Once an ALEC becomes designated as an eligible telecommunications carrier serving a designated territory, the ILEC may petition the Commission to abandon that part of its territory that is identically served by the ALEC. An ILEC must petition the Commission prior to any sale of any part of its territory to another entity. Moreover, existing exchanges may not be split or partitioned by the ILECs. Any transfers of territory must occur on at least an exchange-by-exchange basis.

While the Commission believes that benefits flow to customers from resale competition, it also wants to encourage facilities-based competition. The Commission is especially concerned that facilities-based competition may initially occur only in the more densely populated urban areas. The less densely populated rural areas may or may not experience the benefits of sufficient facilities-based competition. The Commission finds that USF payments to eligible telecommunications carriers should be based upon the number of single (first line only) residential lines served within a designated area and should be portable. Using the number of rural, as opposed to all, residential access lines served by an eligible telecommunications carrier means that the USF payment per line will be relatively higher than would otherwise be the case. The Commission believes this policy will provide a crucial incentive for ALECs to construct facilities and compete with ILECs in the more rural parts of the state.

All ILECs will be designated as eligible carriers. The term "facilities-based" means that the retail end-user has an alternative means of connecting to the network at large by some means other than through the ILEC. USF payments to eligible carriers will be calculated in the following manner. The dollar amount of an ILEC's NTSRR will be taken out of access and toll rates and transferred to and collected through the USF. Though the ILEC will initially receive the same amount of money from the USF as before, the payment will be based upon the number of rural households served. Dividing the total USF revenue, what was formerly known as NTSRR, by the number of rural households served yields a USF payment per rural household served. If a facilities-based ALEC takes a rural customer from an ILEC, the USF payment for that household will be transferred to the ALEC serving that customer. ALECs will not receive USF payments for taking urban customers from ILECs. However, USF payments will decrease commensurate with basic local exchange rate increases. These matters will be addressed extensively in workshops.

The urban versus rural customer distinction is only relevant to BellSouth, GTE, CBT, and ALLTEL. All other ILEC customers will be designated as rural. Therefore, the USF payment for these other ILECs may be based upon their respective total numbers of residential customers. This issue, as all universal service issues, will be decided through a workshop process.

Since the goal is to promote basic connectivity to the network, only the first access line per household will be eligible to be counted toward the calculation of the subsidy. Second or multiple lines per customer will not receive the subsidy. Households with incomes capable of sustaining multiple communications lines into the house or subscribing to advanced technological services should not receive subsidies beyond those for their basic local exchange service. To do so would run counter to the spirit of universal service goals.

Miscellaneous USF Issues

Current universal service subsidization is, in part, funded through embedded rate elements in various service rates. The 1996 Act has mandated that future universal service subsidies be explicitly funded. Therefore, it is important that residential ratepayers be made aware of the amount of USF contribution to their monthly telephone service. The amount of USF subsidy should be listed as a credit on customers' bills to inform them of its existence and size.

The 1996 Act specifies that schools, libraries, and health care facilities must have access to technologically advanced telecommunication services and be supported through discounted rates.[108] Kentucky recently instituted a statewide telecommunications network called the Kentucky Information Highway.[109] In general, these facilities have access to the network at the discounted rates inherent in the Commonwealth's contract. Therefore, the Commission finds that Kentucky has already satisfied this requirement of the 1996 Act. However, if the existing Kentucky Information Highway contract fails to cover all entities covered by the 1996 Act, the Commission will

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108 47 U.S.C. § 706.

109 See Case No. 95-151, Proposed Special Contract of South Central Bell Telephone Company on Behalf of the Local Exchange Telephone Carrier Group for the Kentucky Information Highway, RFP ET-41-95.